Nos. 54–56

# In the Supreme Court of the United States

OCTOBER TERM, 1941

THE UNITED STATES OF AMERICA, PETITIONER

*v.*

JAMES M. RAGEN

THE UNITED STATES OF AMERICA, PETITIONER

*v.*

ARNOLD W. KRUSE

THE UNITED STATES OF AMERICA, PETITIONER

*v.*

LESTER A. KRUSE

WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

## BRIEF FOR THE UNITED STATES

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## CITATIONS

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*ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

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## BRIEF FOR THE UNITED STATES

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### OPINION BELOW

The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 487–505) is reported in 118 F. (2d) 128.

## JURISDICTION

The judgments of the Circuit Court of Appeals were entered February 26, 1941 (R. 505–507). The petition for writs of certiorari was filed April 25, 1941, and granted June 2, 1941 (R. 511). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, and the Rules of Practice and Procedure in Criminal Cases, promulgated by this Court.

## QUESTION PRESENTED

The respondents were convicted of a wilful evasion of income taxes of a corporation by making distributions of corporate profits to the stockholders under the guise of payments of "commissions" which were deducted from the corporation's gross income. The principal question presented is whether there is a sufficiently definite standard of guilt for the jury to convict if any of the distributees rendered any services at all to the corporation.

## STATUTES AND REGULATIONS INVOLVED

The relevant provisions of the statutes and regulations involved are set forth in the Appendix, *infra*, pp. 36–37.

## STATEMENT

On August 22, 1939, an indictment in five counts was returned against the respondents and others in the District Court for the Northern District of Illinois (R. 2–27). The first four counts

charged the defendants jointly with wilful attempts to defeat and evade income taxes of the Consensus Publishing Company, a corporation, for the years 1933 through 1936 by causing the company to file returns which were false and fraudulent. In substance, the charge was that there were deducted from the gross income of the company as business expenses certain amounts designated as "commissions," which were in fact dividends or distributions of profits (R. 2–18). The deductions thus claimed were as follows: 1933, $54,537.65 (R. 6); 1934, $60,172.23 (R. 10); 1935, $76,713.75 (R. 14); 1936, $119,755.78 (R. 18).

The fifth count of the indictment charged a conspiracy to commit such offenses for the years 1929 through 1936, consisting of a scheme to distribute the net profits of Consensus in the guise of "commissions" or salaries for services. It was charged that the scheme involved, among other things, the execution of spurious employment contracts and the falsification of books and records (R. 18–27). This count also alleged that the defendants did not in fact perform any services for the company by virtue of the employment contracts.

The jury returned a verdict finding each of the respondents guilty on all five counts, except Lester Kruse, who was found guilty on the fourth and fifth counts (R. 237–238).[1] The court imposed

[1] The corporation also was convicted and fined (R. 237, 245), but took no appeal.

the following sentences: Arnold W. Kruse, eighteen months' imprisonment and a $10,000 fine; William Molasky, a year's imprisonment and a $10,000 fine; James M. Ragen, Sr., imprisonment of a year and a day and a $10,000 fine; James Ragen, Jr., and Lester A. Kruse, fines of $1,000 each (R. 239–245). On appeal to the Circuit Court of Appeals for the Seventh Circuit the convictions were reversed (R. 505–507).[2] The Government's petition for rehearing was denied on March 18, 1941 (R. 507).

The evidence supporting the verdict of the jury may be summarized as follows:

*Organization and Business of the Company.*—The Consensus Publishing Company, the taxpayer corporation, was organized under the laws of the State of Illinois in 1929 (R. 334, 373) pursuant to an agreement between Moses L. Annenberg, Arnold W. Kruse, James M. Ragen, Sr., and William Molasky, for the purpose of carrying on the business of printing and selling "run-down" sheets to bookmakers (R. 323, 392). The "run-down" sheet business was originally started in St. Louis in 1927

[2] Various preliminary motions and pleas were filed by the respondents, which were overruled or denied by the District Court. The Circuit Court of Appeals, however, held that the District Court erred in dismissing special immunity pleas in bar filed by William Molasky and James Ragen, Jr. (R. 491–496). The Government has not requested that this ruling, which affects only William Molasky and James Ragen, Jr., be reviewed by this Court.

or 1928 by Julius Zweig. However, shortly after Molasky brought out a competing sheet, Zweig sold a sixty percent interest in his business to Molasky and associates for $1,000, and later disposed of his remaining forty percent interest in the same manner for $9,500 (R. 319, 320). Thereafter the business spread to Cincinnati and other places (R. 498).

The "run-down" sheets, printed and distributed daily, showed the horses running at the various race tracks throughout the country with their post positions and code numbers for deciphering racing information sent out over the wire service furnished by Nationwide News Service, an Annenberg corporation, of which James Ragen was general manager (R. 322, 392). Since the racing information contained in the wire service referred to each horse by "cryptic" code number rather than by name, it was necessary to purchase the "run-down" sheets in order to be able to use the wire service (R. 393).

This business, while lucrative, was mechanically simple. It merely involved noting and printing on a sheet the racing information which came over the News Service wires and the distribution thereof to bookmakers at twenty-five or thirty-five cents a sheet (R. 320–321). Printing and selling costs were low, type setting could be done by one man in four or five hours, and the printing itself by another in one or two hours (R. 321). The collection of receipts, preparation of records and

reports and such supervision of the printing of the sheets as was required, which "wasn't much", was done by Gordon Brooks, an employee of another company owned by Molasky (R. 350–351). In Cincinnati the "run-down" sheets were printed by the American Racing Record, another Annenberg company (R. 356), and distributed by one Surlin, a news distributor for Annenberg (R. 356). All receipts were sent to the St. Louis office where they were received and deposited in a bank account by Brooks (R. 353). The foregoing activities required, at most, about an hour or an hour and a half of his time every day, except that once a week "he might spend three hours" making out the operating reports for the Chicago office (R. 351). In answer to repeated questions by the court at the trial, Brooks testified that there wasn't much supervising that had to be done but that he did all of it and no one else did any (R. 352).

*Stock ownership and records.*—The 100 shares of stock of the company were divided as follows: Cecelia Investment Company (an Annenberg holding company), thirty shares, Molasky, thirty shares, Arnold Kruse, twenty shares, James Ragen, Sr., twenty shares (R. 333–334, 385).[3] The evi-

[3] Thirty shares originally were issued to Molasky, of which fifteen shares were subsequently transferred to his niece, B. Hoffman (R. 334, 375, 429, 497, 499). The distributions on the shares in the name of B. Hoffman were deposited in Molasky's own account upon which his niece had no right to

dence shows, as the court below conceded, that the one hundred shares of stock of the company were first issued to "dummies" with the exception of thirty shares which were issued to Molasky (R. 497). The respondents strongly contended that they were not stockholders, and that all the stock was owned by the Cecelia Investment Company. The court below, however, recognized that the record (R. 333, 348, 350, 364) justified the conclusion that the defendants were in fact stockholders (R. 499).

The company maintained its principal business office at St. Louis, Missouri. The books, however, were kept in the Chicago office of the Daily Racing Form, an Annenberg company, and tax returns were filed in the Chicago District. Each week reports of all the receipts and expenses of the

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draw (R. 427–429). Twenty shares originally were issued to A. W. Kruse in the name of "Clark," and held by Kruse, the distributions thereon being assigned to his wife and son, Lester Kruse (R. 334, 377, 497, 499); in 1935 a new certificate for these shares was issued in the name of Herbert S. Kamin as "dummy" for Kruse (R. 379, 380). The distributions made in the name of his wife were, however, deposited in his own account (R. 427), as were those made in the name of his son in 1933 and part of 1934 (R. 427, 428); other distributions were placed in an account which was in the name of his son, but all of the checks on which, with few exceptions, were drawn by him (R. 363, 427–429). Twenty shares were issued to J. M. Ragen, the distributions thereon being assigned to J. M. Ragen, Jr., in 1931 (R. 334, 376, 426–428, 499). Changes in the distribution of profits were not accompanied by changes in stock records. In 1937 distributions were again made directly to Molasky and Kruse (R. 429).

business, showing the balance of profits remaining after the deduction of expenses, were sent from the St. Louis office to the Chicago offices of the Annenberg companies, which operated under the supervision of Arnold Kruse (R. 322, 351). The bookkeeper who received these reports constructed his own work sheets on which he computed the receipts, expenses, net profits, and distribution of the profits (R. 414). Reports showing this information were sent to the stockholders each week (R. 334). The bookkeeping system was set up as directed by Arnold Kruse (R. 410, 411, 416).

*Distribution of profits.*—The net profits of the business were distributed weekly in direct proportion to the stockholdings (R. 324, 340–341, 358–359, 426–428). The respondents contended, however, that Cecelia alone received dividends, the balance of the net profits, or seventy percent, being distributed not as dividends but as commissions for services.[4] The books of the company showed

[4] The respondents contended, and, although attaching little significance to it, the court below found some testimony to sustain the contention (R. 500), that an arrangement was made at the inception of the business to pay commissions for services. This contention is based on the testimony of Howard Clark, the first bookkeeper, who was called as a witness of the court, as to a conversation alleged to have taken place at that time between Annenberg, Kruse, Ragen, Sr., and Molasky. The alleged conversation was repeated verbatim three times (R. 416, 419, 421) by the witness at widely spaced intervals in his cross-examination, although he denied having memorized it. In any event, the jury by its verdict rejected this testimony, as it was fully justified in doing.

these distributions as commissions, as was necessary if they were to be claimed as a deduction for business expense (R. 327–330).[5] This was in accordance with instructions from Kruse who told the bookkeeper to charge seventy percent of the net profits of the company as commissions (R. 411). There is, however, substantial and cogent evidence that the payments were in fact dividends or distributions of profits and not commissions. The confidential weekly reports to the stockholders from October 12, 1929, through August 19, 1933, and from June 5, 1937, through November 5, 1937, labeled these distributions as dividends (R. 330–335, 337, 414).[6] Similarly, from September 1929, through August 19, 1933, and in some instances thereafter, the private work sheets of the bookkeepers showed distributions of "dividends"

[5] The court below apparently attached some significance to the fact that the tax returns disclosed the deductions in question (R. 501). Obviously, however, the listing of these deductions in the returns was essential if a reduction of the taxable net income of the corporation were to be secured. Again, the opinion states as a fact that the returns had been audited, implying that the Government had knowledge of the facts. This receives no support in the record, as the trial court repeatedly advised that questions concerning such examinations were immaterial (R. 437, 438, 440). Further, such an examination, even if made, would not be binding on the Government. *Cooper* v. *United States*, 9 F. (2d) 216, 223 (C. C. A. 8th); *Guzik* v. *United States*, 54 F. (2d) 618 (C. C. A. 7th), certiorari denied, 285 U. S. 545.

[6] Most of the other weekly reports used the descriptive phrase "dividends and commissions" (R. 334). One contained the statement "No dividends this week." (R. 337.)

rather than "commissions" (R. 329–330, 337, 338, 358, 361, 411, 412, 418). Molasky and his niece reported these distributions as dividends in their tax returns for the years 1933 through 1935 (R. 398 and Ex. 47–53). A letter from a bookkeeper to Molasky, dated December 21, 1933, stated that "no dividend checks" would be issued until he could talk with Kruse with respect to the five percent tax on dividends (R. 331). Kruse advised the bookkeeper that the division among the stockholders was an arbitrary arrangement (R. 342–344).

*Destruction of stock records and execution of pre-dated contracts of employment.*—In 1934, Kruse, becoming concerned about a Board of Tax Appeals decision holding that distributions of profits as commissions but in accordance with stockholdings would not be allowed as a deductible expense (R. 393–397), instructed an employee to destroy the original stock book of the company. He also instructed the employee to issue new stock certificates to the original incorporators from a new stock book as of the date of the incorporation of the company, September 18, 1929; and, also as of the same date, to cancel such new certificates and issue one certificate for one hundred shares of stock to Cecelia. The instructions as to the new certificates were followed. The original stock book, however, was not destroyed until sometime later and the original stock certificates were retained by the stockholders until 1938 when they

were carefully torn up or otherwise destroyed.[7] The destruction of the original stock book, an admittedly "irregular procedure" (R. 379), was desired by Kruse in order to avoid "unnecessary questions" (R. 375) being raised with respect to the stock ownership (R. 376). In April 1935, Kruse himself caused his original stock certificate to be cancelled and a new one from the original stock book, which had not then been destroyed, to be issued in the name of a "dummy" (R. 380).

In 1935, or 1936, Kruse instructed an employee to draw up written contracts of employment between the company and the individuals in whose name the profits of the company had been distributed (R. 381–384). Purported employment contracts were drawn and dated back over all the years to and including 1930, and were signed in bulk by the individuals (R. 399, 400, 403, 404, 407). In addition, corporate minutes reflecting the "stock issue" in 1934 and these contracts were also drawn up and dated back for the entire period from 1930 for which no minutes had previously existed (R. 378, 383, 384).

The court below, while failing to see their relevance to income tax evasion, recognized that these transactions "strongly indicate that some sort of chicanery was in progress" (R. 501).

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[7] Molasky's certificate was torn up and thrown down a toilet, Kruse's was torn up and thrown in a wastebasket, and Ragen's was burned (R. 384, 385).

*Whether defendants performed any services.*—The court below stated (R. 500) that there was "considerable testimony in the record of services rendered by Molasky, who was president of Consensus, as well as by Kruse, Sr., and some evidence of services performed by the other defendants." Molasky and Arnold Kruse undoubtedly did perform some services (R. 322–323, 326, 341, 354–355). But there is also evidence that little or no services were performed by the other respondents (R. 341, 353, 355). The witness Burris, an employee of another Annenburg company, who did bookkeeping work for Consensus for two years (R. 339), testified that he had no knowledge of any work that Lester Kruse, or Ragen, Sr., or Ragen, Jr., ever did for Consensus (R. 341, 344). The bookkeeper Brooks similarly stated that, although he had talked to them over the telephone, he did not know any of these men and had never seen them in the office of Consensus (R. 353, 355). When pressed on his statement that he had often talked to Lester Kruse, he was unable to remember when he ever talked to him and finally admitted he had done so only twice (R. 355).

None of the respondents testified or offered any testimony in his own behalf.

The court charged the jury in part as follows[8] (R. 470–471):

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[8] The only exception taken to this charge was as follows (R. 473):

"I take exception to the doctrine announced at if they find that this tax, or any substantial part thereof, was evaded

So it is a vital question in this case of whether the Consensus Company was entitled to deduct from its income the sums distributed to the defendants as ordinary and necessary expenses of its business. The question is whether it should not rather have reported that those distributions were distributions of the profits of the company to its shareholders rather than the payment of compensation to employees and about that this whole case centers.

* * * * *

If, on the other hand, if they were intended to and represented actual bona fide compensation to employes of this corporation in the ordinary operation of its business; in other words, if they were ordinary and necessary expenses of the operation of the business, then they were properly deductible as they were deducted and no tax was due upon them.

* * * * *

Men that work for corporations are entitled to proper compensation, whether they be stockholders, directors, or officers. They are entitled to reasonable compensation for such services as they may render, irrespective of their official connection with the corporation. On the other hand, shareholders are entitled to a division of the profits of the corporation in the way of dividends and it is for you to decide whether these were, or whether a substantial portion

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or attempted to be evaded, that they may find the defendants guilty."

thereof was, a distribution of profits rather than the compensation of employes.

I use the words, "These sums or a substantial portion thereof." *It is not necessary for the government under this indictment to prove that all of the sums so distributed to these defendants were profits.* It is not necessary that the government prove all of the figures precisely as they are charged in the indictment. *It is sufficient if you find beyond a reasonable doubt that the defendants intentionally diverted profits of this concern, in the amounts charged in the indictment or substantial parts thereof,* diverted them from the form of profits and received them in the form of commissions. That, as I said, comes back always to the ultimate question that you have got to decide. [Italics supplied.]

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the standard of guilt was unconstitutionally indefinite.

2. The Circuit Court of Appeals erred in holding that where a statute permits a reasonable deduction for services a criminal prosecution cannot be maintained by proof other than that such services were not rendered.

3. The Circuit Court of Appeals erred in holding that when the proof showed that services had been rendered, the trial should have proceeded no further.

4. The Circuit Court of Appeals erred in holding that the Government had the burden of establishing that none of the defendants rendered any services to the Consensus Publishing Company.

5. The Circuit Court of Appeals erred in holding that the charge of the District Court was improper.

6. The Circuit Court of Appeals erred in reversing the judgments of the District Court.

## SUMMARY OF ARGUMENT

### I

The single issue raised by the indictment was whether the defendants wilfully attempted and conspired to evade and defeat in any manner the income taxes of the Consensus Publishing Company in violation of Section 145 (b). The indictment did not charge, nor did the Government undertake to prove, that none of the respondents rendered any services to the corporation. The basic question was whether the defendants wilfully and fraudulently employed the "commissions" device as a means for distributing corporate profits to the stockholders, and the evidence presented to the jury was amply sufficient to sustain a finding that they did.

The prosecution was maintainable even though some services may have been rendered. The gist of the offense charged by the indictment is not the

amount of tax evaded, but rather whether there was a wilful attempt "in any manner to evade or defeat any tax." Section 145 (b). The decision below that the prosecution is not maintainable where some services have been rendered erroneously rests upon the doctrine of *United States* v. *Cohen Grocery Co.*, 255 U. S. 81, where it was held that a criminal statute which is so vague as to compel a man to speculate at his peril as to whether his actions fall within the statute is invalid under the due process clause.

The doctrine of that case has no application here where there is involved the question of the standard of proof before a jury rather than the validity of the statute itself. Moreover, even if the doctrine were otherwise applicable, the court has misapplied it here. The essence of Section 145 (b) is that the evasion must be wilful. Accordingly, the defendant is never left to speculate whether his acts fall within the statutory prohibition.

## II

The brief also undertakes not only to show that there was no variance between the indictment, or the Government's theory of the case, and the proof, but also to discuss the propriety of the charge to the jury, although it is not clear to what extent these questions are involved in this case.

## ARGUMENT

*Introductory.*—In substance, the Government contended in the court below that the evidence showed that the defendants were stockholders of the Consensus Publishing Company and attempted to conceal that ownership; that, in an effort to cheat the Government of taxes, they knowingly received dividends on the stock owned and held by them and attempted to conceal and misrepresent the character of these distributions so that they might be fraudulently deducted from the corporation's gross income as business expenses. These contentions are fully consonant with the charges contained in the indictment and are amply sustained by the record.

The first four substantive counts of the indictment, charging wilful attempts to evade and defeat the income taxes of Consensus Publishing Company for the years 1933 through 1936, alleged in substance that the returns of the Company were false and fraudulent in that they included among the deductions taken from gross income certain amounts designated "commissions," which were in fact distributions of profits or dividends. The fifth count, charging a conspiracy to commit similar offenses for the years 1929 to 1936, inclusive, alleged, among other things, that the respondents were not employed in any capacity by the corporation by virtue of the so-called "employment con-

tracts * and rendered no services by virtue of such contracts.

On these charges the single issue before the trial court and the jury was whether the defendants wilfully attempted and conspired to evade and defeat in any manner the income taxes of the Consensus Publishing Company in violation of Section 145 (b). This was a simple issue of fact, resolved by the jury's verdict. The majority opinion of Circuit Judge Major, however, contains an elaborate narration of the evidence (R. 497–502). It undertakes to cast a balance between the conflicting inferences, approving some of the Government's contentions (R. 499), and more of the respondents (R. 500–502). The plain inference of this otherwise irrelevant and rather one-sided discussion is that the court reversed because it did not think the evidence sufficient to support the verdict.* The opinion itself nowhere makes any such express ruling; it does, however, contain the assertion that the Government had the burden of establishing that none of the defendants had rendered any services to the corporation (R. 502), and that the trial should have terminated upon a showing that services had been rendered by at least some of the defendants (R. 503).

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* The respondents in their answers to the Government's petition for certiorari assert that the principal question involved is the sufficiency of the evidence (Br. in Op. No. 974 [1940 Term], p. 2; Br. in Op. Nos. 975 976 [1940 Term], p. 3).

It is our position that the verdict was fully warranted even though some of the defendants may have rendered some services, and that the District Court correctly charged the jury (R. 471) that "It is not necessary for the government * * * to prove that all the sums so distributed to these defendants were profits. * * * It is sufficient if you find beyond a reasonable doubt that the defendants intentionally diverted profits of this concern, in the amounts charged * * * or substantial parts thereof * * *." In short, we contend that, whether or not any services may have been rendered, there has been a criminal violation of the income tax laws if the defendants, with intent to evade taxes, fraudulently utilized the "commissions" device as the means for distributing substantial amounts of corporate earnings to the stockholders. Such, in essence, was the charge to the jury, and its verdict in response thereto is amply supported by the record. The fact that the essential operations of the company were simple and were carried on largely by part-time employees; the fact that at least some of the defendants rendered no services at all, or at best, only fragmentary services; the fact that the profits of the enterprise were distributed weekly in exact proportion to stock ownership;[10] the fact that the bookkeepers' work sheets and weekly reports re-

[10] Since the defendants were in fact stockholders, as the opinion of the court below concedes (R. 499), the contention that seventy percent of the net profits was distributed to the

ferred to these distributions as "dividends"; the fact that Molasky and his niece actually reported the distributions as dividends; the fact that the defendants participated in the destruction of critical documents and in the execution of spurious predated contracts of employment—all these furnish overwhelming support for the jury's conclusion that the "commissions" device was wilfully employed as a means for distributing corporate earnings.

If, in the face of such substantial evidence and the persuasive inferences that may properly be drawn therefrom (*United States* v. *Mann*, 108 F. (2d) 354 (C. C. A. 7th)), the court in fact reversed because it did not think the evidence sufficient to support the verdict, it would have been guilty of a flagrant invasion of the province of the jury. *Burton* v. *United States*, 202 U. S. 344; *United States* v. *Brown*, 116 F. (2d) 455 (C. C. A. 7th); *United States* v. *Mann*, *supra*. Further, it would have proceeded in complete disregard of the fundamental principles of appellate review that the reviewing court will only look to the record to see if any substantial evidence appears which supports the verdict, and, in determining whether there is such evidence, will view the evidence in

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defendants as commissions leads to the anomalous conclusion that only one of the stockholders, the Cecelia Company, received dividends.

the light most favorable to the Government"[11] (*United States* v. *Glasser*, 116 F. (2d) 690 (C. C. A. 7th); *Maddelin* v. *United States*, 46 F. (2d) 266 (C. C. A. 7th); *Walker* v. *United States*, 93 F. (2d) 383 (C. C. A. 8th)), and will assume that all conflicts were resolved against the respondents. *Morrissey* v. *United States*, 67 F. (2d) 267 (C. C. A. 9th).

However, the court attempted to avoid running afoul of these rules of appellate review, and did not expressly rule upon the question whether the evidence supported the verdict. Instead, it reversed the judgments upon the ground "that where a statute permits a reasonable deduction for services, a criminal prosecution cannot be maintained by proof other than that such services were not rendered" (R. 502). And the opinion indicated further that proof of the rendition of any compensable service required a directed verdict (R. 503). The contrary result, said the court (R. 502), would leave to the triers of fact the deter-

[11] Moreover, belated arguments on the evidence following the refusal of the respondents to take the witness stand are entitled to little consideration.

"The argument is one not infrequently presented to an appellate court, where the accused is convicted on evidence which to him seems unimpressive and which he declined to explain or dispute by his own word spoken from the witness stand. * * * But, on appeal, when he challenges the evidence to support a verdict against him, he cannot fairly ask a court to assume that the prejudicial facts which are unexplained could have been overcome on various hypotheses had the accused testified." *Guzik* v. *United States*, 54 F. (2d) 618, 620 (C. C. A. 7th).

mination of whether the amount charged is unreasonable, with the consequence that the standard of guilt would be unconstitutionally indefinite. Cf. *United States* v. *Cohen Grocery Co.*, 255 U. S. 81.

We respectfully submit that the court erred, and will contend first that the prosecution can be maintained even though some services may have been rendered, and second that there was no variance between the indictment, or the Government's theory of the case, and the proof.

## I

### THE PROSECUTION WAS MAINTAINABLE EVEN THOUGH SOME SERVICES MAY HAVE BEEN RENDERED

1. The gist of the offense charged by the indictment is not the amount of the tax alleged to have been evaded, but rather, in the language of Section 145 (b), *infra*, p. 36, the wilful attempt "in any manner to evade or defeat any tax." *Gleckman* v. *United States*, 80 F. (2d) 394, 401 (C. C. A. 8th), certiorari denied, 297 U. S. 709. The Government is not required to prove evasion of the entire amount charged. *Tinkoff* v. *United States*, 86 F. (2d) 868, 878–879 (C. C. A. 7th), certiorari denied, 301 U. S. 689. Accordingly, any variation from the indictment figures is wholly immaterial if, as correctly charged by the trial court, a substantial portion of the payments involved constituted distributions of corporate profits rather than true commissions.

The court below did not deny that ordinarily a conviction could be supported if evasion were proved in a lesser amount than that charged in the indictment. The narrow ruling of the court relates solely to the situation where the evasion is accomplished by means of improper deductions, such as deductions for payments of reasonable compensation. In that situation, said the court (R. 502), the Government must prove that no services at all had been rendered, for, if services had been rendered it would be necessary to determine their reasonable value, resulting in an indefinite standard of guilt.[12] However, it does not

[12] The path marked out by the court below in reaching this conclusion, as we follow it, starts with the finding that some services were rendered, continues with the statement that services are naturally compensable, and ends with the finding that since business expenses are deductible by statute, the issue presented to the jury was whether the respondents had taken deductions of unreasonable amounts for services. Such a charge, according to the court below, furnishes no valid basis for a criminal prosecution as there is lacking a sufficiently definite standard of guilt to guide the jury in its deliberations. The possibility that the jury might justifiably have found that all the distributions in question were dividends is answered by the finding that the trial court's instructions permitted the jury to determine what portions were a distribution of profits and what portions would be deemed reasonable compensation for services. The logic of this progression, we submit, is at best doubtful. Compensation may perhaps ordinarily follow the performance of services, but, particularly in the circumstances here presented, the inevitability of the sequence is by no means clear. Stockholders do not always receive their rewards for such services as they may render in the form of salaries and commissions.

at all follow that even where some services may have been rendered, the distributions may not be dividends in their entirety. But even if it may be necessary to diminish the distributions by the reasonable value of the services rendered, we nevertheless submit that the respondents have perpetrated a fraud upon the revenues and that they were not subjected to an indefinite standard of guilt.

2. The decision below rests upon *United States* v. *Cohen Grocery Co.*, 255 U. S. 81, and related cases where it was held that a criminal statute so vague in terms as to compel a man at his peril to speculate as to whether his actions fall within the statutory prohibition, violates the constitutional requirement of due process. But that doctrine can have no application to the crimes specified in Section 145 (b), for Congress has there provided for the punishment of "any person who *willfully* attempts in any manner to evade or defeat any tax." [Italics supplied.] This is not language so vague and indefinite that innocent men must at their peril grope for an intelligible meaning.

At the very outset, it should be observed that the court has erroneously extended the doctrine of the *Cohen Grocery* case far beyond its proper limits. That doctrine condemns statutes which, unlike that here involved, contain language so vague as to be incapable of intelligent interpretation. It does not strike at whatever uncertainty may be engendered in the mind of an individual

as to whether or not a jury may find a particular act to fall within the proscriptions of an unambiguous statute. The standard of guilt by which the respondents were judged is no less definite or less susceptible of uniform application than standards applied in cases of manslaughter, for example, where conviction may turn on whether or not there was criminal negligence or adequate provocation or sufficient time for a reasonable man to cool off. Such uncertainty is often present. As this Court pointed out in *Nash* v. *United States*, 229 U. S. 373, 377:

> * * * the law is full of instances where a man's fate depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree. If his judgment is wrong, not only may he incur a fine or a short imprisonment, as here; he may incur the penalty of death. "An act causing death may be murder, manslaughter, or misadventure according to the degree of danger attending it" by common experience in the circumstances known to the actor. * * *

Cf. *United States* v. *Wurzbach*, 280 U. S. 396, 399.

But even assuming that the doctrine of the *Cohen Grocery* case is otherwise applicable to this type of situation, the court below misapplied it here. It proceeded in complete disregard of the fact that the statute requires that there be a *wilful* attempt at evasion. *United States* v. *Murdock*, 290 U. S. 389. This requirement affords

full protection for the innocent and removes all grounds for constitutional attack because of indefiniteness. On several occasions this Court has noted that a successful attack based on undue vagueness cannot be made where the sanctions of the statute apply only if intent or *scienter* is first established. *Omaechevarria* v. *Idaho*, 246 U. S. 343, 348; *Hygrade Provision Co.* v. *Sherman*, 266 U. S. 497, 501.[18] The most recent recognition of the confining force of the requirement of intent is found in *Gorin* v. *United States*, 312 U. S. 19, involving convictions under the Espionage Act of June 15, 1917. In discussing the contention that certain sections of that Act were too indefinite, this Court said (p. 27):

> But we find no uncertainty in this statute which deprives a person of the ability to predetermine whether a contemplated action is criminal under the provisions of this law.

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[18] This Court has never held a statute invalid for indefiniteness where *scienter* was clearly required for the violation. Section 4 of the Lever Act was held invalid in *United States* v. *Cohen Grocery Co.*, *supra*. The statute as quoted in 255 U. S. at 86 reads as though intent were required. But the full text of the section, as set out in 255 U. S. at 81–82, shows that intent was no part of the clauses under attack. As stated in *Gorin* v. *United States*, 312 U. S. 19, 26, that case "points out that the statute there under consideration forbade no specific act, that it really punished acts 'detrimental to the public interest when unjust and unreasonable' in a jury's view." To the same effect, see *Commonwealth* v. *Reilly*, 248 Mass. 1, 4–7, 142 N. E. 915, 918 (Mass. 1924); *Usary* v. *State*, 112 S. W. (2d) 7, 10–11 (Tenn. 1938).

> The obvious delimiting words in the statute are those requiring "intent or reason to believe that the information to be obtained is to be used to the injury of the United States, or to the advantage of any foreign nation." This requires those prosecuted to have acted in bad faith. The sanctions apply only when *scienter* is established.

It seems clear, then, that even assuming that the court below properly construed the charge against the respondents, the rule against indefiniteness has no relevance here. However, we contest the narrow construction placed upon the charge by the court below. The respondents were indicted on the charge that they had wilfully attempted to evade and defeat taxes in violation of Section 145 (b). That section does not particularize the means of violation, but covers all wilful attempts to evade any tax "*in any manner.*" And "* * * by the words 'in any manner' in Section 146 (b) [of the Revenue Act of 1928, substantially identical with the provisions of Section 145 (b) involved herein], Congress indicates an intention to cover all possible methods of evasion; * * *." *United States* v. *Miro*, 60 F. (2d) 58, 60 (C. C. A. 2d). "The real character of the offense lies, not in the failure to file a return, or in the filing of a false return, but rather in the attempt to defraud the government by evading the tax. The technique may differ, but the opus is the same" *Emmich* v. *United States*, 298 Fed. 5, 9

(C. C. A. 6th), certiorari denied, 266 U. S. 608. See also *Capone* v. *United States*, 56 F. (2d) 927 (C. C. A. 7th); *Paschen* v. *United States*, 70 F. (2d) 491 (C. C. A. 7th).

Whether attempts to evade taxes take the form of false deductions [11] or failure to file a return or omission of items of gross income, the crime and the standard by which it is measured remain the same. The standard involved in the trial of this case, we submit, is that prescribed by Section 145 (b) which defines the crime charged against the respondents. The court below, however, has disregarded that standard and passed over the requirement that there be a wilful evasion. Instead, it has seized upon the civil provisions in Section 23 (a), permitting deduction of reasonable business expenses and, in effect, has viewed the prosecution as based on that section. In so doing, it has read an important and wholly unwarranted limitation into Section 145 (b).

This decision means that a taxpayer taking any deduction, so long as it is claimed under a provi-

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[11] The court below, in stating that "we find no case where the evasion charged was based upon an improper deduction" (R. 502), overlooked such cases as *Tinkoff* v. *United States*, *supra*, involving false deductions for bad debts; *United States* v. *Kelley*, 105 F. (2d) 912 (C. C. A. 2d), involving fraudulent depreciation deductions; and *United States* v. *Zimmerman*, 108 F. (2d) 370 (C. C. A. 7th). See also *Wagner* v. *United States*, 118 F. (2d) 801 (C. C. A. 9th), certiorari denied October 13, 1941, No. 180, present Term, affirming a conviction for tax evasion based upon fictitious bad debts and inflated depreciation.

sion which permits a reasonable deduction, is immune from prosecution, no matter how great the fraud, if only some proportion of the deduction can be shown to be legitimate. Many provisions of the income-tax laws require or permit adjustments in gross income or in deductions which are not capable of precise mathematical calculation.[15] Under the decision of the court below, for example, it would

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[15] The following sections of the Internal Revenue Code (53 Stat.) are illustrative: Sec. 23 (a) (1), "All the ordinary and necessary [business] expenses * * * including a reasonable allowance for salaries"; Sec. 23 (k) (1), "Debts ascertained to be worthless"; Sec. 23 (l), "A reasonable allowance" for depreciation and obsolescence; Sec. 23 (m), "a reasonable allowance for depletion"; Sec. 23 (p) (1), "a reasonable amount transferred" to a pension trust; Sec. 25 (a) (4) (A), "a reasonable allowance" for the taxpayer's personal services; Sec. 27 (a) (4), "reasonable" amounts set aside to retire indebtedness; Sec. 27 (d), (e), (f), "fair market value"; Sec. 101 (4), building and loan associations "substantially all the business of which is confined" to membership loans; Sec. 101 (6), organizations "no substantial part of the activities of which is carrying on propaganda"; Sec. 101 (12), agricultural cooperatives "if substantially all" their stock is owned by producers; Sec. 102 (a), corporations "formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders"; Sec. 102 (c), earnings "permitted to accumulate beyond the reasonable needs of the business"; Sec. 105, oil and gas properties "the principal value of" which has been demonstrated by the taxpayer's exploration; Sec. 112 (b) (1), "property held for productive use in trade or business or for investment (not * * * held primarily for sale * * *)"; Sec. 113 (b) (1), "Proper adjustment" for expenditures, depreciation, etc.; Sec. 119 (b), "expenses, losses, and other deductions properly apportioned or allocated" to income from within the United States; Secs. 166 and 167, "substantial adverse interest" in the disposition of the trust or its income.

seem that none could be convicted of a wilful evasion of income taxes so long as he showed that his property had suffered *any* depreciation, or so long as he could show that he had incurred *any* business expense of the challenged type. Tax returns of necessity involve judgment as well as mathematical computations. That men may differ on matters of judgment should afford no protection to those who wilfully make false returns. Any other rule would grant a license to evade taxes to those astute or facile enough, in their efforts to cheat the Government, to perpetrate their fraud through exaggeration and distortion rather than through reports of wholly imaginary transactions.

We urge that the intentionally broad scope of the enforcement provisions of the revenue laws should not be, and, in fact are not, subject to so serious a restriction. The crime with which the respondents were charged is clearly embraced within Section 145 (b), and the jury by its verdict has found them guilty of that crime. That verdict, we believe, was fully warranted by the evidence and should stand.

## II

### THERE WAS NO VARIANCE BETWEEN THE INDICTMENT, OR THE GOVERNMENT'S THEORY OF THE CASE, AND THE PROOF; THE CHARGE TO THE JURY WAS PROPER

1. The court below suggests (R. 502, 503–504) that the indictment, as well as the theory upon

which the case was tried, argued, and briefed, placed upon the Government the burden of establishing that the defendants had not rendered any services. Thus, the court asserts that the indictment charged, impliedly in the first four counts and explicitly in the fifth count that "none of the defendants 'rendered any services to the said corporation.'" This is a clear misreading. The first four counts of the indictment are wholly silent as to the rendition of services. The fifth count does not allege that no services had been performed. Rather, it alleges that none of the defendants performed any services for the corporation *by virtue of the so-called employment contracts* (R. 23). This follows naturally upon the companion charge, supported by substantial evidence, that these contracts, which had been executed in gross and dated back, were spurious. Contrary to the court's assertion, then, the Government did not assume the burden of establishing the affirmative of the proposition that none of the defendants had performed any services.[18] Its burden was limited to the single issue of whether the respondents attempted and conspired to evade and defeat in any manner the income taxes of the Consensus Publishing

[18] The same error is present in the answer of the court below to the Government's argument that every means alleged in a conspiracy need not be proved, namely, that here there was but one means alleged "and that was that the defendants caused Consensus to take a deduction as commissions when no services were rendered * * *" (R. 505).

Company in violation of Section 145 (b). Whether or not some services were performed by some of the respondents is not alone decisive of this issue. If profits were distributed as dividends to stockholders, the fraud was no less because some of the stockholders may have rendered services to Concensus. That is merely one fact among many, all of which, together with the inferences that may properly be drawn from them, must be considered. In the aggregate they constitute substantial evidence of guilt and fully justified the verdict of the jury.

Again, according to the court below, "the Government in its brief and in oral argument * * * asserts that the deductions in question must be treated either as dividends in their entirety, and if so as unlawful deductions, or as commissions in their entirety, and therefore properly deducted" (R. 502). From this it appears that the court understood the Government to contend that these deductions *must* be either wholly dividends or wholly commissions, and that conviction was impossible unless they were proved to be dividends in their entirety. We respectfully assert that the Government made no such contention; it did not rely upon any such "all or nothing" theory. The Government did contend that all the distributions were in fact dividends and that the evidence was amply sufficient to warrant a finding by the jury that such was the fact. But the whole includes

all its parts, and it was entirely proper for the jury to determine that at least part of the distributions were dividends. The Government's position that the distributions were dividends in their entirety did not carry with it the implication that if they were not dividends in their entirety no part thereof could be dividends.

Thus, the indictment did not allege, nor was it incumbent upon the Government to prove, that none of the respondents had performed any services for the company. In any event, the respondents were under no misapprehension as to the charge against them, which was the distribution of profits in the guise of salaries and commissions. Accordingly, even assuming that a variance existed, it was immaterial. *Berger* v. *United States*, 295 U. S. 78; *Bennett* v. *United States*, 227 U. S. 333.

2. The preceding discussion discloses also the absence of any tenable basis for the suggestion of the court below that the criticized portion of the charge to the jury was neither consistent with the indictment nor the theory upon which the case was tried (R. 503). Further, we believe that viewed as a whole,[17] as of course it must be, the charge was "exceedingly thorough and fair" (Kerner, C. J., dissenting, R. 505). The jury was fully

[17] The court below conceded that "this particular portion of the charge appears less harmful when read in connection with the charge as a whole than when standing alone" (R. 504).

and correctly instructed as to the true issues involved, and when returned to its proper context the unexceptionable character of the portion singled out for criticism becomes manifest. Its purpose was clearly to advise the jury of the settled principle that the Government is not required to prove the entire amount of the tax charged to have been evaded. *Tinkoff* v. *United States, supra; Gleckman* v. *United States, supra.* It is difficult to conceive how the jury could be misled by this charge. Indeed the only exception taken to it by the respondents was that it embodied the "doctrine" that the jury might find the respondents guilty if it found they evaded any substantial part of the tax (R. 473). That exception is, of course, groundless.[18]

Not only was the instruction in question proper; it was a requisite to a fair and complete charge. It is conceivable that the jury might have returned a less sweeping verdict. A dividing line might have been drawn by the jury between the periods before and after the issuance of the new stock certificates in August 1934, or the execution of the so-called

[18] There is a serious question whether the exception taken to the trial court's charge was sufficient to present any question for appellate review. The ground on which the exception was expressly based has no merit, and an exception furnishes no basis for reversal upon any ground other than the one specifically called to the attention of the trial court. *United States* v. *United States Fidelity Co.*, 236 U. S. 512, 529; *Pasche* v. *United States*, 70 F. (2d) 491, 503 (C. C. A. 7th).

employment contracts, and at one or the other of these times the respondents, or some of them, might have been found to have exchanged the garb of stockholders for that of employees. Again, the jury might have found that Molasky, who reported his distributions as dividends in his own tax returns for the years 1933, 1934, and 1935, did not participate in the scheme of tax evasion until, as president of the company, he executed the new stock certificates, or, if the employment contracts were believed spurious by the jury, until he executed such an agreement. In each of these hypothetical instances the charge in question would have been essential for conviction.

## CONCLUSION

For the reasons set out above, it is respectfully submitted that the respondents were properly convicted and that the decision below should be reversed.

Respectfully submitted.

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# APPENDIX

Revenue Act of 1932, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *.

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SEC. 145. PENALTIES.

* * * * *

(b) Any person required under this title to collect, account for, and pay over any tax imposed by this title, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

* * * * *

Revenue Act of 1934, 48 Stat. 680:

Section 23 (a) is identical with Section 23 (a) of the Revenue Act of 1932 above quoted. (U. S. C., Title 26, Sec. 23.)

Section 145 (b) is identical with Section 145 (b) of the Revenue Act of 1932 above quoted. (U. S. C., Title 26, Sec. 145.)

Revenue Act of 1936, 49 Stat. 1648:

> Section 23 (a) is identical with Section 23 (a) of the Revenue Act of 1932 above quoted.
>
> Section 145 (b) is identical with Section 145 (b) of the Revenue Act of 1932 above quoted.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

> ART. 126. *Compensation for personal services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> Article 23 (a)–6 is identical with Article 126 of Treasury Regulations 77 above quoted.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> Article 23 (a)–6 is identical with Article 126 of Treasury Regulations 77 above quoted.

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